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FROM FODAG

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SUBJECT: REPORT OF FAO 102ND FINANCE COMMITTEE

1. Summary. The 102nd session of the UN Food and Agriculture Organization (FAO) Finance Committee met May 5-9, 2003. Committee members were divided on the question of the 2004-2005 budget level, with the U.S. and

Japan supporting zero nominal growth, G-77 members supporting real growth, Switzerland supporting zero real growth and the UK silent. The budget will be examined again at the September Finance Committee Session. Although recognizing the seriousness of FAO's after-service medical care liabilities, the Finance Committee was not ready to take a decision on funding and will consider the matter further in September. As a result of U.S. objections, the Committee sent back the Secretariat's Split Currency Assessment and Capital

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Budgeting proposals for more work. These will be before the September Finance Committee session for decision as well. Throughout the session, USDel stressed accountability and the need to ensure that proper financial management controls were in place, as recommended in last year's Report of the External Auditor and this year's Joint Inspection Unit (JIU) report. As noted in the JIU report, poor personnel practices and weak management at FAO country offices seriously hamper FAO's work and must be kept at the top of the agenda. End Summary.

2. The 102nd session of the FAO Finance Committee (FC) met May 5-9, chaired by Humberto Molina Reyes (Chile) and Anthony Beattie (UK) as Vice-Chair. The nine member committee is composed of Tanzania, Pakistan, the UK, Kuwait, Japan, Chile, Switzerland, Senegal and the U.S. The entire report of the Finance Committee will be sent to the FAO 124th Council session (June 23-28, 2003). Those items on which the Council must take action are noted below.

1. Financial and Budget Reports

3. Agenda Item 3, Annual Report on Budgetary Performance and Program and Budgetary Transfers:

-- As in previous years, the main variance from the budget concerns the shortfall in support cost income resulting from the decline in development projects being implemented by the FAO. The Committee once again called on FAO to adequately plan for the risk and the impact of reduced income earnings.

-- Director of Program and Budget, Tony Wade, told the Committee that FAO recognized the need to adapt to declining income. Wade noted that the FAO Director General (DG) did not want to increase support cost charges; rather, FAO "would be able to manage the reduction through re-deployment of staff."

-- At the request of USDel, the FC Report notes "concern" over the deficit incurred as a result of increased activities of the Investment Center in 2002. The deficit will need to be covered from the Technical Cooperation Department's budget in 2003.

4. Comment and follow-up: The Annual Report on Budgetary Performance and Program and Budgetary Performance is transmitted to Council for information. The actual transfers will be approved at the September 2003 FC session.

5. Agenda Item 4, FAO Interim Accounts. The FC took note of the information provided.

6. Agenda Item 5, Report on Investments: The Committee took note of the report and discussed, in particular:

-- Declining income earnings from investments;

-- The resulting underfunding of staff-related

liabilities for which long-term portfolio income was intended to provide;

-- After a third year of under-performance, the decision to terminate the investment manager (Fiduciary Trust) and seek new managers;

-- The need to increase in-house expertise and monitoring capability of FAO's investments. Should FAO move to a split-currency assessment, it does not have the in-house expertise to handle the monthly spot currency transactions that would be required.

17. Comment and follow-up: See additional discussion of after-service medical care liabilities under the Program of Work and Budget. FAO members will need to address the fact that liabilities far eclipse the possibility of assets addressing them; that assets have been under performing badly; and that management of these assets poses problems for the organization in terms of the number and skills of staff members.

18. Agenda Item 6, Financial Highlights and status of assessed contributions: The Committee took note of the report and discussed, in particular:

-- FAO's liquidity has significantly improved following receipt of U.S. arrears. (Finance Director Nick Nelson noted that the organization was almost forced to resort to external borrowing last year as a result of cash-flow problems);

-- The shortfall in contributions was higher than last year at this time, chiefly because Japan had not yet paid its annual contribution.

-- The balance in the Special Reserve Account also reflected the positive effects of net favorable currency variations in the current biennium (in fact, foreign exchange gains amounted to USD 12.6 million and could reach USD 20 million by the end of the biennium);

-- The General Fund continued in deficit, and ongoing amortization of the unfunded after-service medical care liabilities would increase the deficit;

-- The Technical Cooperation Program (TCP) balance of USD 81.8 million showed that the rate of TCP expenditure was still low;

-- Since FAO's management and administrative costs related to the Oil for Food (OFF) Program were funded entirely through the OFF program, the eventual suspension of the OFF program would not affect the Regular Program Budget in 2003.

19. Comment and follow-up: The Financial Highlights are transmitted to the FAO Council for information.

II. Oversight Matters

10. Agenda Items 7 and 8, 2002 Annual Activity Report of the Office of the Inspector General and Progress Report on Implementation of the External Auditor's Recommendations: Inspector General Pete Wilson briefed the FC on items 7 and 8. The FC took note of the Reports with the following comments:

-- Welcoming the creation of the Audit Committee and the information that staffing in the Finance Division was "now satisfactory."

-- Noting the need for more precise timetables for implementation of the External Auditor's recommendations;

-- Stressing the importance of achieving full and timely implementation of the recommendations relating to internal controls;

-- Requesting that the review of progress be a standing item for the FC.

11. Comment and follow-up: The lack of an Audit Committee and the need for increased staffing in the Finance Division were two of the most important issues raised in last year's Report of the External Auditor.

The FC should continue to monitor closely the FAO's follow-up to the 2002 Report of the External Auditor and stress full and timely implementation.

12. Agenda Item 9, Program of Work of the External Auditor: The External Auditor explained that the Technical Cooperation Program (TCP) had been picked for a "value for money" audit. The rationale included the fact

that TCP is the third largest program funded by the regular budget, and delivery is low; only two percent of the current year appropriation had been spent so far and decentralization, according to the External Auditor, "creates new risks." The report will be presented in 2004.

13. Agenda Item 10, Appointment of the Inspector General: The FC is "consulted" on the appointment of the Inspector General (IG). The FC was informed of the selection process and the DG's intention to name Ms. Amelia Lo Fasso (U.S.) as the new IG on the retirement of incumbent Pete Wilson (Canada) in August 2003.

14. Agenda Item 11, UN Joint Inspection Unit (JIU) Reports: The Finance Committee transmitted the JIU reports on Water Management and Involvement of Civil Society NGO's to the Program Committee for action.

-- The FC discussed JIU report 2002/3 on Support Costs Related to Extrabudgetary Activities in Organization of the UN system. The Committee welcomed FAO's assurance that "extrabudgetary resources should only be accepted consistent with the policies, aims and activities of the organization."

15. Agenda Item 11, continued, Report on Management and Administration in the FAO (JIU/Rep/2002/08):

-- It was noted that FAO management stated that "the majority" of the JIU recommendations were being implemented. However, some would need to be submitted to the Governing Bodies and others would be considered by the Program or Finance Committees. Members requested that FAO provide a follow-up on the implementation of recommendations.

-- The Finance Committee is charged with follow-up on personnel policies relating to FAO Country and Regional Representatives and a proposal that the term of the External Auditor be limited. The September Finance Committee will have proposals by FAO management on both of these issues.

-- USDel took issue with the FAO Director General's rejection of the JIU recommendation that selection of country and regional representatives should follow standard personnel selection procedures. USDel also noted the importance of following up on the JIU recommendations on improving management in country and regional offices, particularly given the increasing decentralization of FAO activities.

16. Comment and follow-up: In discussion with FAO senior staff, USDel was (informally and unofficially) encouraged to continue with this message. It seems that FAO staff themselves are all too conscious of the weakness of FAO country representatives under the current selection process whereby the DG appoints them as his "personal representatives." The JIU reports will be transmitted to the FAO Council for information.

III. Financial Policy Matters

17. Agenda Item 12, Capital Budgeting:

-- As a result of USDel objections to the proposal on capital budgeting, the FC did not endorse the proposal and requested the Secretariat to revise the proposal without a reserve fund (using only Chapter 8 of the Program of Work and Budget); allowing for prior review of proposals by the Finance Committee and allowing for approval of such proposals by a separate Conference

resolution.

-- Budget Director Tony Wade argued that the FAO proposal "offered more accountability than anything in the UN system," called attention to WFP's recent adoption of a capital budgeting mechanism, and argued that FAO - like any other large organization or company -- needed a means of tracking capital assets.

18. Comment and follow-up: We expect that the Secretariat will be urging the FC to take a final

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decision on capital budgeting at the next session.
Proposed changes to the Financial Regulations will be submitted as well in September.

19. Agenda Item 13, Review of Project Proposals to Confirm Compliance with FAO's Mandate: The FC took note of the document without discussion.

¶20. Agenda Item 14, Proposal to Establish a Special Fund for Emergency and Rehabilitation Activities:

-- Anne Bauer, Director of FAO's emergency programs, informed the Committee that the fund was designed to speed up FAO's response in emergencies; it would not be used for procurement of inputs, but for assessment missions. The fund would remain totally outside of the regular Program of Work and Budget (PWB) and presented "no risk" to the PWB, according to Bauer. Bauer also reported that donors had already expressed interest in supporting the Special Fund.

-- The FC supported the proposal, noting that the FAO Director General has the authority to establish such a fund on his own authority.

¶21. Innovative Models for Leveraging Resources in Support of the Field Program:

-- The FC endorsed the proposed amendment to Financial Regulation 6.7, after discussion of the modalities for moving responsibility for project execution to national authorities. It was noted that the FAO proposal closely tracked that of other UN agencies and programs.

¶22. Comment and follow-up: The proposed amendment will be submitted to FAO's Committee on Constitutional and Legal Matters and submitted to the 125th Council for transmission to Conference.

¶23. Agenda Item 16, Information Note on the Cost of the World Food Summit Five Years Later: The FC took note of the document without discussion.

IV. Budgetary Matters

¶24. Agenda Item 17, Summary Program of Work and Budget (SPWB) 2004-05:

-- The U.S. and Japan reiterated requests for a zero nominal growth scenario; the G-77 members supported a real growth scenario, and Switzerland supported a zero real growth scenario. The U.K. was silent.

-- Without prejudice to the overall budget size, the Committee considered the cost increase calculations to be consistent with the agreed methodology. The Committee also emphasized the importance of resolving amortization of the liability for after-service medical care, as investment income can no longer cover these costs.

-- Some members expressed the view that the best option for amortizing the liability would be to approve the Secretariat's proposal to include an earmarked USD 14.1

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million in the PWB starting from 2004-2005 and continuing for the subsequent eleven biennia (depending on investment performance and subject to actuarial recalculation).

¶25. Comment and Follow-up: Among the items on which the FC agreed to take a decision in the September Finance

Committee is how to handle amortization of unfunded liabilities associated with after-service medical costs. The Secretariat will prepare a paper on the subject. Concerning the final budget level, we do not expect the September Finance Committee to come to any conclusion (nor in fact for a decision to be reached until the November/December Conference.) The Summary Program of Work and Budget will also be transmitted to the FAO Council session.

¶26. Agenda item 18, Split Assessments:

-- As a result of USDel objections, the Committee did not endorse the Secretariat's proposed methodology for a split currency assessment (SCA). USDel argued that split assessment was burdensome for members and that the FAO should be responsible for managing its resources in the economic environment in which it operated. USDel also argued that the proposed methodology lacked transparency, as adjustments would be made automatically between biennia for exchange rate fluctuations.

-- The Secretariat was requested to prepare an additional methodology that protected the PWB against exchange rate fluctuations within the biennium, but not between biennia "and to compare this with the Secretariat's methodology."

-- UKDel stated that the U.S. position raised an important question which needed to be examined by the UK authorities; that being said, UKDel confirmed that he in

fact agreed to the need to protect the budget from exchange rate fluctuations within and between biennia. The UK also stated that there was no significant additional burden in paying in two currencies.

-- The Delegate of Pakistan stated that he supported the principle that the budget should be protected both between as well as within biennia. He agreed that the Finance Committee could look at the question again, but cautioned that the Committee "should not become deadlocked."

-- A number of countries pursued the question of whether Euro-zone countries should provide the Euro portion of any split currency assessment, arguing that the exchange rate "risk" should be transferred to those countries best positioned to handle the risk. The Secretariat responded that those countries only provided 38.48 percent of the budget (whereas the FAO's Euro needs represent some 44 percent of the budget).

-- The Delegate of Tanzania stated that payment in two currencies could add to the burden of developing countries.

-- Budget Director Tony Wade noted that the proposed methodology closely resembled that of the IAEA and UNESCO, except that the exchange rate was more realistic (both of those organizations use an old exchange rate which, according to Wade, "distorts" the calculations.)

-- Wade also argued that failure to approve a split currency assessment left the organization in danger of having to absorb exchange rate losses in the next biennium - which would require cutting some 500 positions. He noted that he could wait "until September or October" to get a final ok on the SCA, but that if the organization were not to have one, he would have considered "buying forward today."

127. Comment and follow-up: USDel was also requested to prepare a non-paper to circulate to FC members on the subject. The Committee also agreed that the issue needed to be resolved no later than the September Finance Committee session in view of the preparations that the Secretariat would need to make to prepare the budget and

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the Secretariat for the next biennium. Of the nine FC members present, probably one other member (UK) thoroughly understood the issue. We expect the Secretariat to push very hard for member approval of

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their original proposal. The Finance Committee's conclusions (or lack thereof) on the split currency

assessment will be transmitted to the Council.

128. Agenda Item 19, Scale of Contributions 2004-05:

-- As expected, Chile, on behalf of Argentina, requested that Argentina's assessment be reduced.

-- It was noted that this would require other members to meet the difference. A few members suggested that postponing payments was the normal option.

-- The FC agreed to the proposed scale of assessments for forwarding to the Council and took note (but no action) on the Argentine request.

129. Comment and follow-up: We expect that Argentina may request another Latin American country to raise this issue again at Council (Argentina has lost its seat on the Council as a result of arrears). The Council must adopt the proposed scale of assessments.

130. Agenda Items 20, 21, 22, Budget for the European Commission for Control of Food and Mouth Disease; for the Regional Animal Production and Health Commission for Asia and the Pacific; and for the Desert Locust Commission: The FC took note of the reports with minimal discussion.

1V. Human Resources Management

131. Agenda Item 23, Progress Report on Human Resources Management: The FC took note of the progress report without discussion.

132. Agenda Item 24, Statistics of Personnel Services: The FC took note of the document without discussion.

133. Agenda Item 25, Annual Reports of the ICSC and UN Joint Staff Pension Board to the General Assembly and

Summary of the Decisions Taken: The FC took note of the document without discussion.

VI. Organizational Matters

134. Agenda Item 26, Methodology for Determination of Equitable Geographic Distribution:

-- USDel pointed out that the Secretariat paper had incorrectly described the methodology in use by the United Nations in New York for determining geographical distribution in preparing the two "alternatives" for FC consideration. USDel also noted that any methodology was only as effective as management chose to make it.

--Other FC members stated that they needed to know how the alternatives proposed would affect their countries.

--Pakistan noted that the Secretariat's proposal did not address regional distribution, and noted in this regard what he called the "severe" underrepresentation of the region.

-- USDel stated that there were no agreed criteria for regional distribution and that the U.S. would not support creating a methodology for geographic distribution which took into account regional distribution.

-- Japan argued that consistency with other UN agencies was desirable. Other members supported, in principle, a methodology similar to that in use in New York, which takes into account population and contributions.

-- The Delegate of Pakistan stated that "the current system of linking representation to contributions is in general not acceptable."

-- The Secretariat will revise the paper to correct the mistake; the item will be taken up again at the September FC.

135. Follow-up and comment: FC members requested that

the item not be discussed in the meantime at the Council (where it appears on the agenda). The proposal to review the methodology for determining geographic distribution was first proposed by the Latin American and Caribbean region; while the membership as a whole has never agreed to change the methodology, discussion is kept alive by the fact that everyone has something to dislike about the current system. Any change to the system should require the Secretariat to make better efforts to increase representation of underrepresented countries (for instance, by not accepting applications from candidates from overrepresented countries).

136. Agenda Item 27, Progress Report on the Oracle Project: The FC took note of the paper without discussion.

Comment

137. The agenda for the upcoming FC session in September contains a number of complicated but important financial issues, all of which must, in one form or another, be acted upon by the Committee. We expect the Secretariat to push strongly for a Split Currency Assessment methodology which automatically protects the FAO budget between biennia; we expect the Secretariat to similarly push for agreement on a capital budgeting mechanism. And we expect that the Secretariat will push hard for a real growth budget (although this is likely to be postponed for final action to the November/December Conference, as was the case in 2001). Concerning follow-up to the recommendations of the JIU report and that of the External Auditor, the FC must be persevering in insisting on full reporting on follow-up and not lose sight of these important management issues, despite the heavy workload of the Committee sessions. Tamlyn

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